HISTORY OF BANK INDONESIA : BANKING
Period from 1997-1999

Contents :

1. Highlights

The economic and monetary crisis in 1997 was hard to solve. The fall of rupiah value and the raising interest rates triggered massive capital flight. Serious problems were present in the banking liquidity as Inter-Bank Money Market (PUB) crashed. Being the lender of last resort, BI has to maintain the stability of the banking system and payment for the sake of national economic sustainability. This was the toughest period for BI and the banking industry because the public's trust in banking had drastically nose-dived. To save the country's banking industry, huge amount of funds were needed. BI policies were part of the government macro policies. During the crisis period, the policy control was in the hands of the President who was assisted by the Monetary Board. Bank Indonesia was institution to implement the Government policies.

In the crisis, the President required the Minister of Finance and the Governor of Bank Indonesia to ensure healthy national banks grappling with liquidity problems. Apart from that, the merging of the unsound banks and the sound ones was also carried out, and if this did not work, liquidating them was next in line, prioritizing the small depositors. In connection to this, there were several banking policies agreed by the IMF, such as the eliminating of non-viable banks and the taking of comprehensive restructuring of viable banks. So it was approved as required by the IMF that 16 private banks were liquidated on 16 November 1997. It was a policy so controversial that the public was driven to panic.


BI, Pemerintah, DPR
Sepakat soal BLBI

Banking salvation at this stage was done through the issuance of the Government Blanket Guarantee Program of the Public Savings on 28 January 1998. The government also established Indonesian Banking Restructuring Agency (BPPN). The Minister of Finance then regulated that each private public bank was obliged to raise its paid-up capital to Rp 1 trillion. They were given chances to deposit their additional paid-up capital on 31 December 1998, otherwise they would have their banks closed down or merged with other banks to meet the requirement of Rp 1 trillion paid-up capitals. Responding to the regulation, BI facilitated the merger processes through one-stop service. BI also provided financial assistance through Bank Indonesia Liquidity Assistance (BLBI). Pursuant to Act No. 13 of 1968, BI served as the Lender of Last Resort, namely providing liquidity assistance to troubled banks. Meanwhile Act No. 7 of 1992 authorized BI to take the necessary measures in its discretion to protect the sustainability of banking and payment systems.

Then the government and BI began to restructure banks. Based on the CAR which was set at 4%, banks were then classified into three categories; banks with CAR of 4% were categorized as A and were allowed to continue their business; banks with CAR of close to 4% were categorized as B and were allowed to continue their business but needed more additional assets; banks with CAR of below 4% were categorized as C and faced liquidation. In April 1999 the Coordinating Minister for the Economy, Minister of Finance and the Governor of Bank Indonesia announced the

results of the assessment; 72 national private banks were in A category, 28 national private and 12 Local Development Bank (BPD) were in B, and 36 national private banks in C.

In April 1999, 38 banks were liquidated through the judicial format of BBKU (frozen banks). The closure of the banks sparked no significant reaction from the public because the depositors were guaranteed under the Government Blanket Guarantee. The step was followed by the improving of banks of A category. The upgrading began with fit and proper tests for 74 A category and 14 BPD banks' management simultaneously. The management and shareholders failing to meet the requirements were discharged from the banks and each bank had to submit their Business Plan to BI.

2. Direction of Banking Policies 1997-1999

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Following the amendment of Act No. 7 of 1992 concerning the Banking Principles into Act No. 10 of 1998 on Banking, the role of the Central Bank in the banking policies was drastically changed. These changes were, among others, as follows:

1. the authority to issue banking licenses was shifted from the Minister of Finance to the Central Bank Board;
2. bank ownership by the foreign parties were not limited, while adhering to the partnership principle;
3. the development of sharia-based banks;
4. change of bank secrecy scope which formerly included the bank's assets and liabilities of its balance of sheet, to the saving customer and his saving;
5. the formation of the Indonesian Deposit Insurance Corporation (LPS)
6. the establishment of temporary but special institution to restructure the banks.

The Indonesian banking sector was hard hit by the currency exchange rates inflicting several countries in Asia, including (and particularly) Indonesia that began in mid 1997. Bank customers panicked because the rupiah value plummeted so quickly and prompted massive bank runs. As most of the funds were used for speculative purchase of foreign currencies, rupiah plunged further. People were withdrawing cash from their time deposits and current accounts. As a result, many banks experienced a negative current account balance in BI.

Also, BI's apprehension against a possible worse scenario was responded with tight liquidity to the banks to prevent them from being involved in speculative forex deals. The rampant bank runs and tight liquidity was responded by the market and surged interbank interest rate up to 60% on average a year. As many banks failed to repay their interbank borrowings, the lending banks also experienced liquidity problem (domino effect). Inevitably, there were more and more banks with negative balance at Bank Indonesia. This grave financial condition was extremely alarming to the Central Bank as the payment system would be crippled, and further affect the whole economic system. The worse implication would be the shortage of medicine, baby's milk and food and job severance for the workers.

The endurance of the national banking sector was so vulnerable due to its internal factors, such as credit concentration on certain economic sectors, particularly the loans extended to the parties associated with banks. The other contributing factors were the absence of the deposit insurance of the public saving. As a result, the central bank was forced to grant implicit guarantee over the survival of several banks as to avert from systematic default in the banking industry. Aside from that, the impotent act enforcement in general, including the central bank's dependence, affected the moral hazard of the banks' management to make highly risky decisions

in the bank management. The other major issue was the limited information available to the public about the banks' actual financial conditions. As a result, the public were not able to properly control the banks.

In respond to this, bank supervision role was focused on numerous important issues, among others: restricting the maneuver of banks from involving themselves in speculative forex deals, minimizing bank rush by the banks' internal instruments, and requesting the banks to calm down their customers from being excessively jittery.

During the Limited Cabinet Meeting on 3 September 1977, the Government decided to rescue the banks which could survive; ask them to merge or sell a number of banks to those which were financially more viable; and revoked the licenses of the banks that would not survive. The banks that were likely survive were helped with the Central Bank Liquidity Aid (BLBI). Later, 16 banks were declared Banks in Liquidity (BDL), 4 banks were declared Takenover Banks (BTO), 10 banks were suspended (BBO) and 39 banks were restricted from running certain transactions (BBKU). In addition, to rehabilitate the banking sector, the Government injected some fresh funds to 10 Regional Development Banks (BPD) and 9 commercial banks.

Meanwhile, to ease the public panic, the Government provided a blanket guarantee for all their savings in the banks and simultaneously for all the obligations of the banks. The government set up the Indonesian Bank Restructuring Agency (IBRA) to provide such guarantee and restructure the banks already taken over by the Government.

The Government eventually managed to overcome the impacts of the national banking crisis against its counterpart countries through a number of agreements, among others:

1. The Letters of Credit (L/C) issued by the national banks that were not honored overseas were cash guaranteed by BI
2. The debts to overseas creditors were agreed to be rescheduled.

In short, it could be pointed out that the banking policies throughout this period were focused on rescuing the banking system from the crisis by devising the foundations for its future recovery

3. Strategic Steps 1997-1999

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During the crisis, all efforts were made to rescue the national banking system. BI was closely working the Government through a number of forums, among others: limited cabinet meeting focused on economic, finance and banking supervision issues and Prodis on 3 September 1997, revocation of 16 banks' licenses on 1 November 1997, blanket guarantee for public saving on 26 January 1998, identification of banks according to the recapitalization criteria at the end of 1998, government's taking over of banks in May 1998 and suspension of banks' operations in May and August 1998, as well as banning certain banks to be engaged in certain business activities on 13 March 1999.

In view of the deteriorating economic problems, the Government resorted to International Monetary Fund (IMF) for some help. The agreement reached by the Government and IMF was focused on the endeavors to cope with the crisis and banking restructuring contained in the Memorandum on Economic and Financial Polices. This covered comprehensive economic plans. In the banking sector, its revamp measures covered the closure of insolvent banks and restructuring of other banks. Banks that were facing problems were divided into two groups, namely those which had to be recapitalized and those that required intensive control, receivership, or takeover. Restructuring steps were made up formulation of deposit insurance scheme, improvement of the technique and procedure for BI's Liquidity Credit (BLBI), consolidating the bank supervision role, and enhancement of interbank money market.

In addition, to ensure act enforcement and banking revamp in the future, BI worked closely with the Indonesian Police and Attorney General Office. This move resulted in the Joint Decree on the Banking Investigation aimed to step up the legal enforcement effectiveness through joint investigation against alleged banking crimes. In this matter, BI acted as the facilitator to identify such alleged frauds.

Further, in respect to the divestment of the Government's capital participation in several banks to restore the national banking, BI worked closely with IBRA to pick up and approve eligible prospect investors to take over take the Government's stakes in such banks. In respect to this, BI obliged fit & proper test for the prospect investors in terms of their financial standing, track record and vision in the future

4. Supervision Authority 1997-1999

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Upon the amendment of Act No. 7 of 1992 to Act No. 10 of 1998 on Banking, the license granting authorities in banking was shifted from the Minister of Finance to the Central Bank Governor. As a bank supervision authority, during this crisis period, BI exercised its power to cope with the problems which would harm the bank business. Pursuant to Act No. 7 of 1992 on Banking, there were six measures that BI could do, namely

1. the shareholders were requested to increase their capital,
2. the shareholders were requested to replace the board of commissioners and or board of directors of their banks,
3. the banks were requested to write off their non-performing loans and count their losses against the capital,
4. the banks were advised to merge or be consolidated with the other banks,
5. the banks were requested to be sold to the prospective buyers who would be willing to takeover their all bank obligations,
6. BI would take other measures in compliance to the prevailing acts and regulations. If the above measures proved unsuccessful in resolving the problems facing the banks, BI would revoke the licenses of the said banks.

To cope with banking crisis, the Government on 26 January 1998 set up the Indonesian Banking Restructuring Agency (IBRA). This agency was responsible for rehabilitating the Indonesian banks, settling their bad assets and recovering the state's money already disbursed to the banking sector. Pursuant to Act No. 10 of 1998 on Banking, IBRA was responsible only for restructuring the banks considered unhealthy and handed over by BI to IBRA. Beyond this, BI remained in charge of the banking authorities

5. Strategic Goals 1997-1999

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During this period, the supervision by the State Audit Agency was imposed on the use of government bonds for bank recapitalization.